

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
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R 251859Z AUG 77
FM AMEMBASSY MADRID
TO SECSTATE WASHDC 1498
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
AMEMBASSY LISBON
AMEMBASSY LONDON
AMEMBASSY LUXEMBOURG
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY THE HAGUE

C O N F I D E N T I A L SECTION 1 OF 2 MADRID 6310

USEEC

USOECD

E.O.11652: GDS
TAGS: ECON, PINT, EFIN, SP
SUBJECT: UNDERSECRETARY OF FINANCE ON GOVERNMENT'S ECONOMIC PROGRAM

REF: MADRID 5632 AND 5887 (BOTH NOTAL) MADRID 6255

1. SUMMARY: FOR SUCCESS OF GOVERNMENT'S ECONOMIC
PROGRAM, NEW UNDERSECRETARY OF FINANCE PLACES PRIME
IMPORTANCE ON RESTORING INVESTOR CONFIDENCE AND ON
ACHIEVING COOPERATION OF LABOR FOR RESTRAINT IN WAGE
DEMANDS. HE BELIEVES MODERATE MONETARY AND FISCAL
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MEASURES BEING PROPOSED TO REDUCE INFLATION AND TO
STRENGTHEN PUBLIC SECTOR BY EXPANDING REVENUE BASE
SHOULD BE ACCEPTABLE TO BOTH LABOR AND MANAGEMENT.
WITH WHICH GOVERNMENT IS HOLDING A SERIES OF MEETINGS
(SEPTELS). ACCORDING TO THE UNDERSECRETARY, MORE
RESRICTIVE MONETARY POLICY BEING ADOPTED SHOULD REDUCE
RATE OF INFLATION BEGINNING NEXT YEAR. BASIC GOVERNMENT

AIM IS TO FOSTER FREE ENTERPRISE AND MARKET SSSTEM BY GRADUALLY ELIMINATING CONTROLS, SUBSIDIES, AND PRIVILEGED CREDIT CIRCUITS, WHILE EXPANDING AND MODERNIZING PUBLIC SECTOR THROUGH IMPROVED TAX COLLECTION AND OTHER FISCAL REFORMS. END SUMMARY.

2. NEW UNDERSECRETARY OF FINANCE DIONISIO MARTINEZ DISCUSSED PHILOSOPHY AND IMPLEMENTATION OF GOVERNMENT'S ECONOMIC PROGRAM DURING AUGUST 24 COURTESY CALL BY DCM AND EMBOFF. HE CHARACTERIZED SPANISH ECONOMIC PROBLEMS AS DIFFICULT, BUT SESCEPTIBLE TO CORRECTION BY APPLICATION OF WELL CONCEIVED POLICIES. BASIC GOVERNMENT PHILOSOPHY IS DESIGNED TO STRENGTHEN FREE ENTERPRISE AND MARKER SYSTEM BY REDUCING CONTROLS, SUBSIDIES, AND PRIVILEGED CREDIT CIRCUITS. PLAN, HE SAID, IS TO REVERSE TRENDS OF ACCELERATING INFLATION AND GROWING BALANCE OF PAYMENTS DEFICITS BY MORE RESTRICTIVE MONETARY POLICY WHILE EXPANDING AND MODERNIZING PUBLIC SECTOR.

3. SINCE GOVERNMENT HAS ESCHEWED CENTRALIZED ECONOMIC PLANNINGN PROGRAM DEPNEDES ON OBTAINING COOPERATION OF LABOR AND MANAGEMENT FOR WAGE RESTRAINT AND ON RESTORATION OF BUSINESS CONFIDENCE TO STIMULATE LAGGING INVESTMENT AND CREATE EMPLOYMENT OPPORTUNITIES. MARTINEZ SAID GOVERNMENT IS CONVINCED THAT INCENTIVES SUCH AS INVESTMENT TAX CREDITS DO NOT STIMULATE NEW
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INVESTMENT AND THAT MORE IMPORTANT FACTORS ARE POLITICAL STABILITY AND GENERAL ECONOMIC ENVIRONMENT, PARTICULARLY CONTROL OF INFLATION, LABOR CONDITIONS, AND AVAILABILITY OF CREDIT. HE BELIEVES CONSERVATIVE AND RESPONSIBLE PROGRAM BEING PROPOSED BY THE GOVERNMENT SHOULD RESTOR INVESTOR CONFIDENCE AND THAT LABOR CAN BE SHOWN THAT MODERATION OF WAGE INCREASES IS ESSENTIAL TO REDUCING INFLATION. GOVERNMENT HOPES TO REDUCE INCREASE IN CONSUMER PRICES (CURRENTLY INCREASING AT AN ANNUAL RATE OF OVER 26 PERCENT) 18 OR 20 PERCENT BY LOWERING RATE OF MONEY SUPPLY INCREASE TO 18 OR 29 PERCENT BY END OF THE YEAR.

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C O N F I D E N T I A L SECTION 2 OF 2 MADRID 6310

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4. AS TO FISCAL POLICY MARTINEZ SAID GOVERNMENT
INTENTION IS TO INCREASE PUBLIC SECTOR (INCLUDING SOCIAL
SECURITY) SHARE OF GNP GRADUALLY, OVER PERHAPS A TEN
YEAR PERIOD, FROM PRESENT 22 PERCENT TO AROUND 30 OR
32 PERCENT WHICH WOULD BEING SPAIN MORE IN LINE WITH
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MOST OTHER WESTERN EUROPEAN COUNTRIES. RESULT, HE
SAID, WOULD BE MORE "SOCIAL DEMOCRATIC" THAN IN THE US.
BUT LESS THAN THE SCANDINAVIAN OR WEST GERMAN
PRACTICE. TO PERMIT NON-INFLATIONARY EXPANSION OF
PUBLIC SECTOR FOR ESSENTIAL PUBLIC SERVICES OF A MODERN
SOCIETY, ESSENTIAL PART OF GOVERNMENT PROGRAM IS IMPROVED
TAX COLLECTION AND FISCAL REFORM. AIM IS TO INCREASE
CONTRIBUTION OF DIRECT TAXATION TO GOVERNMENT REVENUE,
EVENTUALLY REPLACING PRESENT COMPLICATED SYSTEM WITH

MORE SIMPLE AND ENFORCEABLE TAX ON OVERALL PERSONAL INCOME, WHATEVER THE SOURCE. EVENTUALLY, INDIRECT TAXATION WILL ALSO BE REVISED TO SUBSTITUTE COMMON MARKET TYPE VALUE ADDED TAX FOR PRESENT CASCADING TAX ON BUSINESS TRANSACTIONS, ALTHOUGH THIS CHANGE WILL PROBABLY NOT BE INSTITUTED FOR ONE OR TWO YEARS AFTER RATE IN INFLATION HAS BEEN REDUCED. NEW TAX ON NET WORTH BEING PROPOSED AS PART OF GOVERNMENT'S FISCAL REFORM PACKAGE IS MODELED ON SIMILAR GERMAN TAX AND IS IMPORTANT, NOT SO MUCH BECAUSE OF LIMITED ADDITIONAL REVENUE IT WILL BRING, BUT BECAUSE INEQUALITIES IN WEALTH RATHER THAN INCOME ARE MORE NOTABLE AND POLITICALLY IMPORTANT IN SPAIN. MARTINEZ EMPHASIZED THAT PROPOSED TAX INCREASES ARE MODERATE AND SHOULD NOT BE OF REAL CONCERN TO THE WELL-TO-DO. IN THIS REGARD, MARTINEZ MADE A SPECIAL POINT OF NOTING THAT FOREIGN COMPANIES ESTABLISHED IN SPAIN HAVE NO CAUSE FOR CONCERN SINCE THEY, UNLIKE SOME SPANISH FIRMS, ALREADY PAY TAXES ACCORDING TO LETTER OF THE LAW.

5. MARTINEZ NOTED THAT BECAUSE OF THE LOW LEVEL OF PUBLIC EXPENDITURE IN SPAIN, BUDGET DEFICITS HAVE NOT BEEN LARGE. THIS YEAR, HOWEVER, AS RESULT OF 200,000
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MILLION PESETAS IN ADDITIONAL EXPENDITURES BEYOND THE 900,000 MILLION BUDGETED, THE CENTRAL GOVERNMENT BUDGETARY DEFICIT FOR 1977 WOULD BE 130,000 MILLION PESETAS WITHOUT ADDITIONAL REVENUE. BY MORE RIGOROUS TAX COLLECTING DURING THE REMAINDER OF THIS YEAR AND SOME ADDITIONAL RESTRAINT ON EXPENDITURES, THE GOVERNMENT HOPES TO REDUCE THE DEFICIT TO 65,000 MILLION PESETAS WHICH IS ONLY ABOUT 6 PERCENT OF GNP. PLAN IS THAT 197 BUDGET WILL BE A CONSOLIDATED BUDGET OF THE ENTIRE PUBLIC SECTOR AND WILL TAKE INTO ACCOUNT INCREASED REVENUE ANTICIPATED FROM NEW FISCAL MEASURES. IN 1978 ALSO, HOWEVER, GOVERNMENT WILL HAVE TO MAINTAIN CLOSE CHECK ON EXPENDITURES. ONLY THEREAFTER WILL TAX REFORMS LEAD TO SUFFICIENT ADDITIONAL REVENUE FOR THE INCREASED EXPENDITURES ON SOCIAL SERVICES AND OTHER FIELDS, INCLUDING, HE AGREED, THE MILITARY, IS POSSIBLE.

6. MARTINEZ IS AN IMPRESSIVE HIGHLY COMPETENT 37 YEAR OLD PROFESSOR OF ECONOMICS WHO HAS SPECIALIZED IN TAXATION. AS A MEMBER OF THE SOCIAL DEMOCRATIC PSD. HE IS A FERNANDEZ ORDONEZ MAN, BUT HE HAS ALSO WORKED CLOSELY IN THE PAST WITH FUENTES QUINTANA AND OTHER TOP OFFICIALS OF THE GOVERNMENT'S NEW ECONOMIC TEAM. LIKE FERNANDEZ ORDONEZ, HE STUDIED

FISCAL POLICY AT HARVARD AND WAS STRONGLY INFLUENCED BY THAT EXPERIENCE. HE CHARACTERIZED THE PRESENT GOVERNMENT AS CONSERVATIVE, CENTER-RIGHT IN THE EUROPEAN CONTEXT, AND HE BELIEVES THAT PSOE HAS SHOWN ITSELF TO BE MODERATE AND RESPONSIBLE THUS FAR AS THE MAJOR OPPOSITION PARTY.

7. COMMENT: WHILE PROVIDING THE FOREGOING OUTLINE OF THE GOVERNMENT'S ECONOMIC PHILOSOPHY AND FISCAL PROGRAM, MARTINEZ MADE A SPECIAL POINT OF EXPRESSING CONCERN OVER APPARENT CURRENT LACK OF BUSINESS AND INVESTOR CONFIDENCE. HE SAID THAT THE ENTIRE ECONOMIC

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TEAM, INCLUDING FUENTES QUINTANA, WAS WORRIED ABOUT THIS. THEY REALIZED THE EVENTUAL CONTROL OF INFLATION WAS FUNDAMENTAL TO ACHIEVEMENT OF CONFIDENCE, BUT THIS COULD ONLY COME AFTER CONSIDERABLE TIME, AND THE COUNTRY NEEDED INVESTMENT NOW. HE SPOKE OF THE POSSIBILITY OF FUENTES QUINTANA AND/OR MINISTER OF FINANCE FERNANDEZ ORDONEZ TRAVELLING ABROAD TO EXPLAIN GO'S ECONOMIC AND FINANCIAL POLICES IN ORDER TO REASSURE POTENTIAL INVESTORS. THE DCM ENCOURAGED THIS IDEA. STABLER

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